

Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs

UK Finance response to the BEIS consultation

5 May 2021

Overview

UK Finance is the collective voice for the banking and finance industry operating within the UK. Representing almost 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

As the consultation outlines, if net zero commitments are to be met, there is a need for companies with a material economic or environmental impact or exposure to assess, disclose and ultimately take actions against climate-related risks and opportunities. Increasing the proportion of companies required to take such actions will in turn provide investors with more of the information they need to adequately understand and manage climate-related financial risks and provide other stakeholders with a greater level of information on climate-related matters.

We are broadly in support of the initiative to mandate in statute climate-related financial disclosures by publicly quoted companies, large private companies and LLPs. We view this as a significant step in support of the UK government meeting its statutory commitment to a net zero economy by 2050 and the meeting of more immediate interim targets including the acceptance of the independent UK Committee on Climate Change sixth carbon budget recommendation that by 2035 emissions reduce by 78% in comparison to 1990 levels.

There are, however, issues arising from the consultation that we believe need thinking through carefully to ensure that the statutory obligation best supports the strategies being put in place by leading organizations to put their businesses onto a net zero path. This includes our:

- Suggesting (or seeking clarification) that the requirement for disclosures being made at a group level should extend to disclosures made at group level by overseas parents of UK subsidiaries providing this delivers the expected standard.
- Underlining the importance of BEIS drawing the right conclusion on the climate-related financial information that *must* be provided in the Strategic Report but ensuring that there is nothing in statute precluding the provision of additional, more detailed information separately.

- Seeking an undertaking that BEIS will give close consideration to issues raised by this and the related 'Restoring Trust in Audit and Corporate Governance' consultation paper as to the nature of climate-related financial disclosures that can be included in either the Strategic Report or the proposed mandatory resilience statement and the need for certainty as to the legal definition of the primary users of these statements.
- Seeking reassessment of whether mandated climate-related financial disclosures should include the provision of summary results information on scenario analysis.

Chapter 1: Introduction

We agree with the description of climate change as a financial risk in Chapter 1 of the consultation and the distinction made between physical risks and transition risks. As the commentary observes, disclosure should be seen as a mechanism for change, with improved transparency resulting in informed pricing and capital allocation. Disclosure is an important tool in enabling the transition to net zero.

The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) have become the market standard, with approaching 1,500 companies – including many within financial services – voluntarily beginning to report under the framework provided by the TCFD. It therefore makes a great deal of sense for the UK Government to align its proposals for statutory climate-related financial disclosures to the TCFD recommendations.

We further note that the commitment made by UK Export Finance to disclose in line with the TCFD recommendations as soon as practicable after financial year 20/21, joining CDC, the UK Government's development investment arm, and the Bank of England in making their first climate-related financial disclosures against the TCFD's four pillars. In the case of the former, we note the role played by the Transition Export Development Guarantee in ensuring that oil and gas companies with credible transition plans can benefit from UK Export Finance's working capital support and the 12 month exemption for SMEs¹

We are already on record as welcoming the intention that the UK implements a green taxonomy, or framework for determining which economic activities can be defined as environmentally sustainable, and additionally welcome the UK Government joining the International Platform on Sustainable Finance in order to influence, support and benefit from the development of common international standards on taxonomies. It is important for these taxonomies to be developed in support of whole economy transition to net zero and we look forward to having the opportunity to contribute to the deliberations of the UK Green Technical Advisory Group on Technical Screening Criteria.

We also look forward to working with the UK Centre for Greening Finance and Investment (CGFI) and are pleased to have had the opportunity to express support for its mission to provide world-class data and analytics to financial institutions around the world.

We also welcome the UK Government's intention to use its Presidencies of the G7 and COP26 to promote mandatory climate-related financial disclosures and support the International Financial Reporting Standards (IFRS) Foundation being charged with the establishment of a new, global Sustainability Standards Board. Having global sustainability

¹ Consultation outcome <https://www.gov.uk/government/consultations/aligning-uk-international-support-for-the-clean-energy-transition>

reporting standards is fundamental to global harmonisation and enables consistent and comparable data.

We provide below our responses to the questions posed in Chapters 2 and 3 of the consultation on the scope, depth of the requirements, guidance and monitoring and enforcement regime. We are, in broad terms, supportive in principle for the initiative to extend mandatory climate-related financial disclosures to publicly quoted companies and Limited Liability Partnerships (LLPs).

Chapter 2: Detailed proposals

Summary of proposals for companies and LLPs

Question 1: Do you agree with our proposed scope for companies and LLPs?

We support the application of the mandatory TCFD-aligned disclosures for certain UK companies and LLPs subject to the size threshold as set out in the consultation. This may include some commercial companies with a UK premium listing or standard listing.

UK companies which are premium listed commercial companies will be subject to the comply or explain rules of the FCA in respect of TCFD disclosure requirements. Although this consultation is complementary to the FCA listing rules, premium listed companies would effectively be subject to two separate (but overlapping) regimes, with two separate regulators.

Question 2: Our proposed scope includes UK registered companies with securities admitted to AIM with more than 500 employees. Do you have any views on expanding this to include other unregulated markets and Multilateral Trading Facilities (MTFs)?

We agree with the proposed scope. The commitment to whole economy transition to net zero by 2050, and the achieving of interim targets, is a massive task and it is right to expect that companies and LLPs within the proposed scope explain to stakeholders the part they intend to play and, in the process, acknowledge the expectation that they measure and report upon their carbon emissions

Question 3: Do you agree with the proposal to require climate-related financial disclosures for companies and LLPs at the group level?

We believe that reporting at the group level is appropriate for a subsidiary company to place reliance on the global parent company's disclosure as opposed to disclosing separately.

Part of the objective in putting in place a statutory requirement for climate-related financial disclosures on the part of companies and LLPs is to enhance the prospect of information being measured and reported on a comparable basis. While the complexities are such that statute alone cannot be expected to achieve this, putting in place a requirement at a group level will contribute to disclosures being made on a more common basis than would otherwise be the case.

Most importantly, reporting at a group level will provide investors with the most useful decision-making information, particularly as issuance of debt and equity is most typically conducted via the global parent company rather than at subsidiary level. By utilising the consolidated group reporting, investors will be able to have a more accurate picture of the

progress being made to transition, rather than piecemeal disclosure which does not reflect the consolidated climate footprint of the corporate.

Climate-related disclosure should be aligned with the principles of the financial reporting obligation of the parent entity and their subsidiaries and should therefore be made on a consolidated basis absent any separate listing requirements applicable in relation to a particular subsidiary. This approach is consistent with the UK Companies Act, IFRS, TCFD recommendations (see below), the Science Based Targets initiative (SBTi) criteria (see below) and the relevant listing rules:

TCFD

- *“To fulfill its remit, the Task Force developed four widely adoptable recommendations on climate-related financial disclosures applicable to organizations across sectors and jurisdictions. In developing its recommendations, the Task Force considered the challenges for preparers of disclosures as well as the benefits of such disclosures to investors, lenders, and insurance underwriters.”*
- *“ORGANIZATION refers to the group, company, or companies, and other entities for which consolidated financial statements are prepared, including subsidiaries and jointly controlled entities.”*

SBTi's C5 Criteria (C5 / FI-C5) recommends that *“companies submit targets on at the parent- or group-level, not the subsidiary level”* and states that *“in case where both parent companies and subsidiaries submit targets, the parent company's target must also include the emissions of the subsidiary if it falls within the parent company's emissions boundary given the chosen inventory consolidation approach”*.

This said, any subsidiary of a parent entity which - on a voluntary basis - opts to publish its own subsidiary-level climate-related disclosure could do so irrespective whether its data is also included – on a consolidated basis – in its parent's climate-related disclosure.

We would further underline that climate change is a global challenge and that significant global alliances within the marketplace are being built up. This is illustrated by the launch of the Glasgow Financial Alliance for Net Zero (GFANZ) on 21 April bringing together *in the first instance* over 160 firms together with responsibility for assets in excess of \$70 trillion spanning the world's largest banks, asset owners, asset managers and insurers.

In support of this global initiative, which is both industry-led and UN-convened, we see grounds for suggesting that the requirement for disclosures being made at a group level should extend to disclosures made at group level by overseas parents of UK subsidiaries providing this delivers the expected standard.

UK Ministers have already expressed support for the International Financial Reporting Standards (IFRS) Foundation establishing a Sustainability Standards Board that would work towards the introduction of global sustainability standards, not least in respect of climate. Standard setters, business, the accounting profession and many more are already combining to make this a reality and our expectation is that this approach will be endorsed in intergovernmental meetings this year.

It is of fundamental importance that the UK approach is consistent with the intention that the IFRS Foundation publishes climate-related requirements as this will allow for globally comparable disclosures and harmonisation.

Other disclosures

Question 4: Do you agree that the Strategic Report is the best place for the disclosure of climate-related financial information by companies?

We agree that the Strategic Report is the best place for the disclosure of core climate-related financial information. Some flexibility in the ability to cross-reference to other sections of the Annual Report or supplementary reports would also be welcomed.

As the consultation explains, however, companies which also have a premium listing will be required by the FCA Listing Rules to report against the 11 detailed recommendations on a *comply or explain* basis in the annual financial report. This inconsistency in the location of the disclosures in separate reports could undermine the quality of disclosures, for example, level of audit and assurance may differ.

Absent this mechanism in legislation, it would seem right to pitch the statutory expectation for information that *must* be provided in the Strategic Report at a higher level. Even in this case, we see grounds for BEIS ensuring that there is nothing in statute precluding the provision of additional, more detailed information separately.

The volume of information currently considered necessary in support of climate disclosure is also a relevant factor in determining whether fuller information may need to be given in a separate, designated report. To illustrate, as firms seek to explain their TCFD disclosures more comprehensively, climate reports can approach 100 pages in length.

There is a need for a generally accepted international reporting standard for material non-financial considerations and to recognise that this will take time to develop. Ultimately, non-financial reporting should have a similar standard to financial reporting.

In considering reliance on global group reporting, international regimes may result in different requirements for location of the TCFD aligned reporting. We would encourage the UK rules to take an outcomes-based approach to recognising these group disclosures for climate reporting, rather than an overly strict adherence to the UK approach on the location of the report.

Question 5: Do you have any views on whether LLPs should be required to disclose climate-related financial information in the Strategic Report (where applicable), or the Energy and Carbon Report?

As the consultation explains, the provisions applying to LLPs in respect of Strategic Reports differ from those which apply to companies in that only those LLPs which are traded LLPs or banking LLPs are required to produce a Strategic Report. Large LLPs are, however, required to produce an energy and carbon report under SECR, which forms part of their Annual Report.

It would seem in keeping with the existing approach to require those LLPs required to produce a Strategic Report to include mandated climate-related financial information in this report and for non-traded or non-banking LLPs to utilise their energy and carbon report.

Question 6: Do you agree that requiring disclosure in line with the four pillars of the TCFD recommendations, rather than the 11 recommendation level is suitable?

It is telling to note that the logic behind the regulations themselves not requiring or prescribing the disclosure of climate-related financial information in line with the 11 more detailed TCFD recommendations is that BEIS considers some of the recommendations to be at a level of granularity that would be inconsistent with current legislative requirements in the Strategic Report; also that companies which also have a premium listing will be required by the FCA Listing Rules to report against the 11 detailed recommendations on a *comply or explain* basis.

Whilst we agree with the initial proposal to introduce the mandatory disclosures based around the higher level four pillars, it would be helpful if the guidance could explain that this is viewed as providing the right statutory underpinning for information that *must* be included in the Strategic Report. Where there is a view that increased granularity is required for TCFD aligned reporting, such guidance should be specific to the targeted corporate sector and should be in line with international norms for these sectors, to reduce risk of UK approaches to TCFD reporting being out of synchronisation with other jurisdictions.

Companies and LLPs should also be mindful of the fact that this is the minimal expectation and that investors, regulators and others will be assessing the true nature of a company's appreciation of the climate risks and opportunities facing them according to the insightfulness of their disclosures. Adopting a minimalist 'compliance' approach in inappropriate circumstances will shine through.

Question 7: Do you agree that information provided in line with the obligations set out above would provide investors, regulators and other stakeholders with sufficient information to assess the climate-related risks and opportunities facing a company or financial institution?

Disclosure is of particular importance for investors, regulators and other stakeholders and reporting under the four pillars of TCFD will provide sufficient information to assess the climate-related risks and opportunities faced by a company or financial institution. Consideration should be made for financial institutions that are required to disclose under TCFD and ensuring that counterparty information appropriately matches that required for their own disclosures.

This then raises the question of what it is that BEIS is seeking to achieve through the introduction of a statutory requirement that all companies and LLPs be required to provide climate-related financial information within the Strategic Report (and potentially under the 'Restoring Trust in Audit and Corporate Governance' consultation document the proposed mandatory resilience statement for Public Interest Entities).

It further raises the related question of who can be said to be the *primary* users of this information and the extent to which forward-looking aspects can be included within either statement. This is particularly relevant to scenario analysis that can extend out over several decades and therefore is clearly very different to other financial information that you would expect a company or LLP to report upon.

Question 8: Do you agree with our proposal that scenario analysis will not be required within a company or LLP's annual report and accounts?

The TCFD strategy pillar is defined in terms of the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning being disclosed, subject to materiality. Scenario analysis strikes us as forming a core part of this. There are grounds therefore for suggesting that companies and LLPs should demonstrate an ability to discuss their senior management's thinking on this matter as this is key to investors and lenders understanding how mature the company or LLP is in their thinking about climate change and their assessment of the resilience of their strategy.

TCFD guidance provides that for 'for organizations just beginning to use scenario analysis, a qualitative approach that progresses and deepens over time may be appropriate'.

Therefore, considering the importance of scenario analysis in climate-related disclosures and the ability of a company to start at a level suitable to its expertise, time, resource, we believe it would be more appropriate to encourage companies to include scenario analysis at an appropriate level and then seek to refine over time, with due consideration that the data, methodologies and interpretation of impacts is at an immature stage and that scenario analysis may not always be an appropriate exercise for a company or LLP given these limitations. Should space within the Strategic Report be an issue, then the statutory requirement could be based upon the provision of summary results of scenario analysis.

We would further suggest that it may be useful for the guidance under the legislation to include some minimal requirements surrounding the appropriate scenarios that companies and LLPs may select.

Recognising that quantitative scenario analysis is challenging, the TCFD recommendations themselves suggest that companies building toward this capacity can undertake qualitative scenario analysis. This can be used to explore the potential range of climate change implications, and build capability through exploring potential pathways and outcomes, toward developing modelling capabilities.

Also recognising the advantages of standardised reporting, we would suggest that the benefits of full TCFD compliance could be highlighted, with specific provision made for alternatives (such as qualitative in place of quantitative analysis) as an interim measure.

Question 9: Would alignment of the scope for climate-related financial disclosures and SECR requirements, such that large unquoted companies and LLPs would be subject to the same reporting requirements under SECR as quoted companies, aid reporting of climate related financial disclosures and simplify reporting procedures? Do you have any views on the continuation of voluntary Scope 3 emissions reporting under the SECR requirements?

Yes. It would be helpful for unquoted companies and LLPs to align with the SECR requirements for quoted companies.

Question 10: Do you have any comments on the proposal to permit non-disclosure if the information is not material and the reasons why climate change is not material is properly explained?

Non-disclosure is clearly appropriate in the case that the information is not material. We fully ascribe to the view, however, that there should be a statutory obligation for the reasons why climate change is not material to be clearly explained.

Proposed timing

Question 11: Do you have comments on the proposed timing for these regulations coming into force?

We view the proposed timeline of accounting periods on or after 6 April 2022 as reasonable, noting that the requirements on premium listed companies came into force from 1 January 2021, providing companies and LLPs can be given sight of the expectations to be placed upon them without undue delay once the consultation closes and the results are analysed.

We would emphasise though that there is nothing from stopping companies from making voluntary disclosures before then and that disclosures will be expected to improve over time. The fact that the framework is still being built, data, definitions and metrics are still being worked upon, does not preclude companies and LLPs taking these steps.

Chapter 3: Enforcement, Penalties and Impacts

Proposed Duties and Enforcement

Question 12: Do you have any comments regarding the existing enforcement provisions for companies and the BEIS proposal not to impose further provisions?

The consultation explains that existing provisions will apply to the new duties in connection with climate-related financial disclosures given the new duties will form part of the Strategic Report or the energy and carbon report. We concur with the view that new monitoring or enforcement powers do not appear necessary.

Question 13: Do you have any comments regarding duties and enforcement provisions for LLPs?

We have nothing further to add.

The role of auditors

Question 14: Do you have any comments on the responsibilities of auditors in relation to climate-related financial disclosures?

As the consultation relates, auditors are then required to consider whether there is a material inconsistency between 'other' information and the financial statements. When climate-related risks are financially material for a company, auditors should consider whether and how these should be reflected in a company's financial statements. We note that it is not the intention of BEIS to alter the role of auditors in relation to climate-related financial disclosures, but that the Government's programme of corporate governance and audit reform is expected to strengthen and broaden the FRC's powers and focus as it is transformed into a new regulatory body - the Audit, Reporting and Governance Authority (ARGA).

We would add to this that we would expect better definition of the responsibilities for auditors in relation to climate-related financial disclosures to arise out of the detailed climate work being undertaken by the IFRS Foundation and others and that shortcomings in data, definitions and metrics need to be taken into account in determining the nature of assurance that can be provided.

There is a need for a generally accepted international reporting standard for material non-financial considerations; however, we recognise that this will take time to develop. Over time and as this field evolves, it will be important to revisit assurance requirements, especially for large companies and material KPIs. Ultimately, non-financial reporting should have a similar standard to financial reporting. That said, even if such information is not required to be assured, it should be “assurable” in the sense that in future it is capable of being assured.

We will comment further at a future stage on issues arising from the separate audit and corporate governance consultation document paper and the proposal that climate-related financial disclosures be included in the new resilience statement.

The roles of the FRC and FCA

Question 15: Do you have any comments regarding the proposed enforcement of our disclosure requirements?

The consultation includes a clear explanation of the division of responsibilities between the FRC and FCA, including the fact that the FRC will be primarily responsible for monitoring and enforcement of the Companies Act provisions, whereas information disclosed outside the Annual Report and reporting by in-scope listed companies that are headquartered overseas (around 10% of premium listings) falls within the FCA’s remit. As the consultation observes, it will be important that the two regulators operate a joined up and consistent approach to monitoring and enforcement of these requirements.

Question 16: Do you have any comments regarding the impact of our proposals on protected groups and/or how any negative effects might be mitigated?

We have no comments to make.

Question 17: Do you have any further comments about our proposals?

Members have commented upon the potential benefits of:

- A prescribed reporting format and agreed definitions for ‘core’ metrics such as Scope 1 and 2 emissions
- Reported data being made available through an open source platform or portal (similar to the parallel proposal for SMEs being developed by CDP, International Chamber of Commerce and the governmental SME Climate Hub; noting that the UK Centre for Greening Finance and Investment (CGFI) may have a role to play here
- A common key to identify customers (company numbers for the companies included within portal reporting) to drive data consistency and data quality all round

These are ideas that we would say are worth exploring.

We support improved, globally aligned and consistent non-financial disclosure, in particular climate-related disclosures. A single standard basis of data disclosed will allow investors, financial institutions, and others to assess more accurately their climate impacts.

We would close by underlining our in-principle support and willingness to facilitate further discussion with the banking and finance sector if that would be helpful.

For further information on this submission please contact Paul Chisnall, Director, Sustainability, UK Finance paul.chisnall@ukfinance.org.uk